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WEITERE INFORMATIONEN OK

Thursday, July 17, 2008

So much for the "risk-free investment"

Last week the default risk on U.S. Treasury bonds doubled. This week it has increased still more. This risk is measured by credit default swaps (CDS's), which insure investors against bond defaults. Of course this risk, contrary to a very stupid but very popular myth among U.S. economists, has never has been zero: there is no such thing as a "risk-free" investment. Anybody with a modicum of knowledge of economic history knows (in other words, alas, very few people know) that over historical timeframes government defaults on their debt, both overt and covert (through inflation), are common. Indeed over >20 year timeframes even stocks are less risky than government bonds, but for shorter timeframes bonds are, in nominal terms at least, normally far less volatile than stocks. Reuters observed,

> The cost to insure Treasury debt with credit default swaps jumped to 16.5 basis points, or $16,500 per year for five years to insure $10 million in debt, from 8 basis points on Thursday, an analyst said....Debt protection costs on U.S. government debt are now higher than those for Germany, which trades at 9.5 basis points, and are trading at similar levels as Japan and the United Kingdom, which are around 16.5 basis points, the analyst said.

So far this week it has increased to 22 basis points for five years of default insurance. Bloomberg observes the probable cause of this increased risk:

> Treasury Secretary Henry Paulson said July 13 the U.S. would seek authority from Congress to buy unlimited equity in so-called government-sponsored enterprises Fannie Mae and Freddie Mac and to extend them as much credit as needed. The move effectively put the weight of the treasury behind the companies, which own or guarantee almost half of the $12 trillion in U.S. home loans outstanding. The Federal Reserve also agreed to lend directly to Fannie Mae and Freddie Mac.

In other words, not only is the Federal Reserve now playing John Law by printing dollars to buy bad real estate investments, but now the federal government has declared its willingness to get in on the act in an even bigger way.

Note that default risks measured by CDS's do *not* include the risks of what are effectively ongoing *de facto* mini-defaults on all dollar-denominated debt due to inflation, risks that have been rising substantially over the past ten years, as reflected by the prices of the main insurance against inflation risk, commodities.

In the U.S. there have been a number of de facto inflationary defaults on U.S. federal debt -- the Revolutionary War (Continentals),

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Nick Szabo

"A premier thinker about history, law and economics, and the lessons they have for security." -- Adam Shostack, Emergent Chaos

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"Like most blogs worth my attention, this blog is updated only infrequently. That is because the authors of blogs worth my attention only post when they have something to say that is true, relevant and not already known by their audience. Most of the human race does not have the skill to know when an idea has these three properties. The skill is particularly rare in the fields of politics and economics, which is why this blog is such a rare and valuable thing." -- Richard Hollerith

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Civil War (Greenbacks), Great Depression (resetting the gold conversion rate). The largest de facto default occured in the 1970s (float and inflation) and we are in the midst of one currently (float and inflation) that may turn out to be even larger. But the only overt default on "national" governmental debt in our 232-year history was that of the Confederate States of America in the throes of losing its war against the (rest of the) U.S.

Compared to the 1970s, oil is responding faster and more completely to Fed inflation, and oil remains a crucial part of our industries. As a result, the havoc caused by high oil prices may put a stronger limit this time on how quickly the Fed shredder can dispose of the real value of U.S. paper. If the degree covert default is thus limited, but the risk of default increases, the risk of overt default rises. The market last week seemed to be saying that the Fed may be starting to approach some such limit, perhaps a political limit due to hysteria over gas and food prices, on its practical ability to inflate the U.S. currency. In other words, markets may be saying the Fed cannot necessary resort to a Weimar- or Zimbabwe-style hyperinflation -- that if federal financing gets to that extreme U.S. politicians may choose to overtly default instead.

The city of Vacaville, California recently overtly defaulted on its debt, as have a number of other municipalities in the U.S. Worldwide overt defaults on government debt during the second half of the 20th century usually occured in Third and Second World governments (e.g. Russia in the 1990s), but there were a large number of overt government defaults in governments of all sorts early in the Great Depression (indeed these were a leading cause of that economic disaster), and in prior centuries government defaults wherever governments borrowed money, including leading nations in Western Europe, were common. Mature democracies with central banks that can engage in covert defaults (inflation) have had a far lower rate of overt defaults than other forms of government or democracies without central banks.

That the risk of *overt* default has now substantially increased means that investors are are recognizing that the unprecedented revenue-generating combination created in 1913 -- IRS (which has been able to reliably collect $trillions per year) and the Federal Reserve (which has been reliably able to enage in covert gradual defaults by printing money to buy $trillions worth of Treasury debt per year) -- is not indestructible. U.S. Treasuries, like every other investment, have never been risk-free and they've just gotten quite a bit riskier. Nevertheless compared to historical averages for governments, the risk of overt default by that powerhouse 1913 duo is pretty low. With very high probability they will keep paying interest and principal on their debt while me and my fellow U.S. taxpayers will keep having to shell out substantial sums to the IRS every year, and see our dollars frittered away every year, that this dynamic duo may continue to uphold "the good faith and credit of the United States" while the discreditable activities, often done in rather poor faith, of the federal government in "redistributing" wealth, attacking foreign countries in very expensive ways, promising vast pensions that it cannot pay, promising health care that it cannot fund, and forcing private businesses to do bizarre things (like take on vast amounts of moral hazard by lending into "underserved communities", and to actually fund those government medical mandates) continues.

In related financial news, what I've been predicting for a long time would happen is starting to happen: the U.S. dollar inflation indices PPI and CPI, despite being under-reported compared to prior decades (due to a radical revision of the formulae), are starting to rise to 1970s rates of increase. Sticky prices in manufactured goods and services, as well as wages (the stickiest prices of all), are playing a very long-term game of catch-up to commodity prices, and especially to gold and oil, which are leading indicators of inflation. I continue to predict 5%-15%/year increases in the CPI and PPI, and probable "stagflation" (inflation plus recession, which according to Keynesians is not supposed to happen), until such time as they catch up to the commodity price increases. Commodity prices themselves, despite their stratospheric levels, may continue to increase as the Federal Reserve tries to deal with large government deficits and the fallout from the awful moral hazard in our housing markets, a moral hazard in no small part due to previous inflationary policy by the Fed itself combined with the outrageous pressures from U.S. politicians to relax lending standards in order to get people to buy houses in "under-served communities" and naive "real estate always goes up" bubble behavior on the part of the real estate industry and house buyers. The Fed-and-IRS-backed political franchises Freddie Mac and Fannie Mae have been moral hazard disasters waiting to happen. Inflation is still by far the largest problem these federal activities are causing; the doubling of the overt default risk is just an interesting related blip. My recommendation: keep only spending money, not savings or long-term investments, in

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dollars or dollar-denominated debt, and keep trying to unstick your own wages by frequently asking your boss for a big raise.

On the increase in Treasury default risk H/T to Alex Tabarrok.

Posted by Nick Szabo at 4:49 PM

4 comments:

OldCodger said...

Another reason the Fed may have less room to inflate their way out of this mess is that they have more competition this time. From the euro and as you point out from commodity ETFs and similar. In the 1970s the dollar was the only big game in town. Or the Fed may just have less room because this is a much bigger mess than in the 1970s.

8:57 PM

Anonymous said...

Don't believe one optimistic word from any public figure about the economy or humanity in general. They are all part of the problem. Its like a game of Monopoly. In America, the richest 1% now hold 1/2 OF ALL UNITED STATES WEALTH. Unlike 'lesser' estimates, this includes all stocks, bonds, cash, and material assets held by America's richest 1%. Even that filthy pig Oprah acknowledged that it was at about 50% in 2006. Naturally, she put her own 'humanitarian' spin on it. Calling attention to her own 'good will'. WHAT A DISGUSTING HYPOCRITE SLOB. THE RICHEST 1% HAVE LITERALLY MADE WORLD PROSPERITY ABSOLUTELY IMPOSSIBLE. Don't fall for any of their 'humanitarian' CRAP. ITS A SHAM. THESE PEOPLE ARE CAUSING THE SAME PROBLEMS THEY PRETEND TO CARE ABOUT. Ask any professor of economics. Money does not grow on trees. The government can't just print up more on a whim. At any given time, there is a relative limit to the wealth within ANY economy of ANY size. So when too much wealth accumulates at the top, the middle class slip further into debt and the lower class further into poverty. A similar rule applies worldwide. The world's richest 1% now own over 40% of ALL WORLD WEALTH. This is EVEN AFTER you account for all of this 'good will' 'humanitarian' BS from celebrities and executives. ITS A SHAM. As they get richer and richer, less wealth is left circulating beneath them. This is the single greatest underlying cause for the current US recession. The middle class can no longer afford to sustain their share of the economy. Their wealth has been gradually transfered to the richest 1%. One way or another, we suffer because of their incredible greed. We are talking about TRILLIONS of dollars which have been transfered FROM US TO THEM. All over a period of about 27 years. Thats Reaganomics for you. The wealth does not 'trickle down' as we were told it would. It just accumulates at the top. Shrinking the middle class and expanding the lower class. Causing a domino effect of socio-economic problems. But the rich will never stop. They just keep getting richer. Leaving even less of the pie for the other 99% of us to share. At the same time, they throw back a few tax deductible crumbs and call themselves 'humanitarians'. Cashing in on the PR and getting even richer the following year. IT CAN'T WORK THIS WAY. Their bogus efforts to make the world a better place can not possibly succeed. Any 'humanitarian' progress made in one area will be lost in another. EVERY SINGLE TIME. IT ABSOLUTELY CAN NOT WORK THIS WAY. This is going to end just like a game of Monopoly. The current US recession will drag on for years and lead into the worst US depression of all time. The richest 1% will live like royalty while the rest of us fight over jobs, food, and gasoline. So don't fall for any of this PR CRAP from Hollywood, Pro Sports, and Wall Street PIGS. ITS A SHAM. Remember: They are filthy rich EVEN AFTER their tax deductible contributions. Greedy pigs. Now, we are headed for the worst economic and cultural crisis of all time. Crime, poverty, and suicide will skyrocket. SEND A "THANK YOU" NOTE TO YOUR FAVORITE MILLIONAIRE. ITS THEIR FAULT. I'm not discounting other factors like China, sub-prime, or gas prices. But all of those factors combined still pale in comparison to that HUGE transfer of wealth to the rich. Anyway, those other factors are all related and further aggrivated because of GREED. If it weren't for the OBSCENE distribution of wealth within our country, there never would have been such a market for sub-prime to begin with. Which by the way, was another trick whipped up by greedy bankers and executives. IT MAKES THEM RICHER. The credit industry has been ENDORSED by people like Oprah Winfrey, Ellen DeGenerous, Dr Phil, and many other celebrities. IT MAKES THEM RICHER. Now, there are commercial ties between nearly every

industry and every public figure. IT MAKES THEM RICHER. So don't fall for their 'good will' BS. ITS A LIE. If you fall for it, then you're a fool. If you see any real difference between the moral character of a celebrity, politician, attorney, or executive, then you're a fool. No offense fellow citizens. But we have been mislead by nearly every public figure. We still are. Even now, they claim to be 'hurting' right along with the rest of us. As if gas prices actually effect the lifestyle of a millionaire. ITS A LIE. IN 2007, THE RICHEST 1% INCREASED THEIR AVERAGE BOTTOM LINE WEALTH AGAIN. On average, they are now worth over $4,000,000 each. Thats an all time high. As a group, they are now worth well over $17,000,000,000,000. THATS WELL OVER SEVENTEEN TRILLION DOLLARS. Another all time high. Which by the way, is much more than the entire middle and lower classes combined. Also more than enough to pay off our national debt, fund the Iraq war for twenty years, repair our infrastructure, and bail out the US housing market. Still think that our biggest problem is China? Think again. Its the 1% club. That means every big name celebrity, athlete, executive, entrepreneur, developer, banker, and lottery winner. Along with many attorneys, doctors, politicians, and bankers. If they are rich, then they are part of the problem. Their incredible wealth was not 'created', 'generated', grown in their back yard, or printed up on their command. It was transfered FROM US TO THEM. Directly and indirectly. Its become near impossible to spend a dollar without making some greedy pig even richer. Don't be fooled by the occasional loss of a millionaire's fortune. Overall, they just keep getting richer. They absolutely will not stop. Still, they have the nerve to pretend as if they care about ordinary people. ITS A LIE. NOTHING BUT CALCULATED PR CRAP. WAKE UP PEOPLE. THEIR GOAL IS TO WIN THE GAME. The 1% club will always say or do whatever it takes to get as rich as possible. Without the slightest regard for anything or anyone but themselves. Reaganomics. Their idea. Loans from China. Their idea. NAFTA. Their idea. Outsourcing. Their idea. Sub-prime. Their idea. High energy prices. Their idea. Oil 'futures'. Their idea. Obscene health care charges. Their idea. The commercial lobbyist. Their idea. The multi-million dollar lawsuit. Their idea. The multi-million dollar endorsement deal. Their idea. $200 cell phone bills. Their idea. $200 basketball shoes. Their idea. $30 late fees. Their idea. $30 NSF fees. Their idea. $20 DVDs. Their idea. Subliminal advertising. Their idea. Brainwash plots on TV. Their idea. Vioxx, and Celebrex. Their idea. Excessive medical testing. Their idea. The MASSIVE campaign to turn every American into a brainwashed, credit card, pharmaceutical, medical testing, love-sick, celebrity junkie. Their idea. All of the above shrink the middle class, concentrate the world's wealth and resources, create a dominoe effect of socio-economic problems, and wreak havok on society. All of which have been CREATED AND ENDORSED by celebrities, athletes, executives, entrepreneurs, attorneys, and politicians. IT MAKES THEM RICHER. So don't fall for any of their 'good will' 'humanitarian' BS. ITS A SHAM. NOTHING BUT TAX DEDUCTIBLE PR CRAP. In many cases, the 'charitable' contribution is almost entirely offset. Not to mention the opportunity to plug their name, image, product, and 'good will' all at once. IT MAKES THEM RICHER. These filthy pigs even have the nerve to throw a fit and spin up a misleading defense with regard to 'federal tax revenue'. ITS A SHAM. THEY SCREWED UP THE EQUATION TO BEGIN WITH. If the middle and lower classes had a greater share of the pie, they could easily cover a greater share of the federal tax revenue. They are held down in many ways because of greed. Wages remain stagnant for millions because the executives, celebrities, athletes, attorneys, and entrepreneurs, are paid millions. They over-sell, over-charge, under-pay, outsource, cut jobs, and benefits to increase their bottom line. As their profits rise, so do the stock values. Which are owned primarily by the richest 5%. As more United States wealth rises to the top, the middle and lower classes inevitably suffer. This reduces the potential tax reveue drawn from those brackets. At the same time, it wreaks havok on middle and lower class communities and increases the need for financial aid. Not to mention the spike in crime because of it. There is a dominoe effect to consider. IT CAN'T WORK THIS WAY. But our leaders refuse to acknowledge this. Instead they come up with one trick after another to milk the system and screw the majority. These decisions are heavily influensed by the 1% club. Every year, billions of federal tax dollars are diverted behind the scenes back to the rich and their respective industries. Loans from China have been necessary to compensate in part, for the red ink and multi-trillion dollar transfer of wealth to the rich. At the same time, the feds have been pushing more financial burden onto the states who push them lower onto the cities. Again, the hardship is felt more by the majority and less by the 1% club. The rich prefer to live in exclusive areas or upper class communities. They get the best of everything. Reliable city services, new schools, freshly paved roads, upscale parks, ect. The middle and lower class communities get little or nothing without a local tax increase. Which, they usually can't afford. So the red ink flows followed by service cuts and lay-offs. All because of the OBSCENE distribution of bottom line wealth in this country. So when people forgive the rich for their incredible greed and then praise them for paying a greater share of the FEDERAL income taxes, its like nails on a chalk board. I can not accept any theory that our economy would suffer in any way with a more reasonable distribution of wealth. Afterall, it was more reasonable 30 years ago. Before Reaganomics came along. Before GREED became such an epidemic. Before we had an army of over-paid executives, bankers, celebrities, athletes, attorneys, doctors, investors, entrepreneurs, developers, and sold-out politicians to kiss their asses. As a nation, we were in much better shape. Strong middle class, free and clear assets, lower crime rate, more widespread prosperity, stable job market, lower deficit, ect. Our economy as a whole was much more stable and prosperous for the majority. WITHOUT LOANS FROM CHINA. Now, we have a more obscene distribution of bottom line wealth than ever before. We have a sold-out government, crumbling infrastructure, energy crisis, home forclosure epidemic, credit crunch, weak US dollar, 13 figure national deficit, and 12 figure annual shortfall. The cost of living is higher than ever before. Most people can't even afford basic health care. ALL BECAUSE OF GREED. I really don't blame the 2nd -5th percentiles in general. No

economy could ever function without some reasonable scale of personal wealth and income. But it can't be allowed to run wild like a mad dog. ALBERT EINSTEIN TRIED TO MAKE PEOPLE UNDERSTAND. UNBRIDLED CAPITALISM ABSOLUTELY CAN NOT WORK. TOP HEAVY ECONOMIES ALWAYS COLLAPSE. Bottom line: The richest 1% will soon tank the largest economy in the world. It will be like nothing we've ever seen before. The American dream will be shattered. and thats just the beginning. Greed will eventually tank every major economy in the world. Causing millions to suffer and die. Oprah, Angelina, Brad, Bono, and Bill are not part of the solution. They are part of the problem. THERE IS NO SUCH THING AS A MULTI-MILLIONAIRE HUMANITARIAN. EXTREME WEALTH MAKES WORLD PROSPERITY ABSOLUTELY IMPOSSIBLE. WITHOUT WORLD PROSPERITY, THERE WILL NEVER BE WORLD PEACE OR ANYTHING EVEN CLOSE. GREED KILLS. IT WILL BE OUR DOWNFALL. Of course, the rich will throw a fit and call me a madman.. Of course, they will jump to small minded conclusions about 'jealousy', 'envy', or 'socialism'. Of course, their ignorant fans will do the same. You have to expect that. But I speak the truth. If you don't believe me, then copy this entry and run it by any professor of economics or socio-economics. Then tell a friend. Call the local radio station. Re-post this entry or put it in your own words. Be one of the first to predict the worst economic and cultural crisis of all time and explain its cause. WE ARE IN BIG TROUBLE.

So what can we do about it? Well, not much. Unfortunately, we are stuck on a runaway train. The problem has gone unchecked for too many years. The US/global depression is comming thanks to the 1% club. It would take a massive effort by the vast majority to prevent it. Along with a voluntary sacrifice by the rich. THATS NOT GOING TO HAPPEN. But if you believe in miracles, then spend your money as wisely as possible. Especially in middle and lower class communities. Check the Fortune 500 list and limit your support of high profit/low labor industries (Hollywood, pro sports, energy, credit, pharmaceutical, cable, satelite, internet advertising, cell phone, high fashion, jewelry, ect.). Cancel all but one credit card for emergencies only. If you need a cell phone, then do your homework and find the best deal on a local pre-pay. If you want home internet access, then use the least expensive provider, and share accounts whenever possible. If you need to search, then use the less popular search engines. They usually produce the same results anyway. Don't click on any internet ad. If you need the product or service, then look up the phone number or address and contact that business directly. Don't pay to see any blockbuster movie. Instead, wait a few months and rent the DVD from a local store or buy it USED. If you want to see a big name game or event, then watch it in a local bar, club, or at home on network TV. Don't buy any high end official merchendise and don't support the high end sponsors. If its endorsed by a big name celebrity, then don't buy it. If you can afford a new car, then make an exception for GM, Ford, and Dodge. If they don't increase their market share soon, then a lot more people are going to get screwed out of their pensions and/or benefits. Of course, you must know by now to avoid those big trucks and SUVs unless you truly need one for its intended purpose. Don't be ashamed to buy a foreign car if you prefer it. Afterall, those with the most fuel efficient vehicles consume a lot less foreign oil. Which accounts for a pretty big chunk of our trade deficit. Anyway, the global economy is worth supporting to some extent. Its the obscene profit margins, trade deficits, and BS from OPEC that get us into trouble. Otherwise, the global economy would be a good thing for everyone. Just keep in mind that the big 3 are struggling and they do produce a few smaller reliable cars. Don't frequent any high end department store or any business in a newly developed upper class community. By doing so, you make developers richer and draw support away from industrial areas and away from the middle class communities. Instead, support the local retailer and the less popular shopping centers. Especially in lower or middle class communities. If you can afford to buy a home, then do so. But go smaller and less expensive. Don't get yourself in too deep and don't buy into the newly developed condos or gated communities. Instead, find a modest home in a building or neighborhood at least 20 years old. If you live in one of the poorer states, then try to support its economy first and foremost. Big business is fine on occasion depending on the profit margins and profit sharing. Do your homework. If you want to support any legitimate charity, then do so directly. Never support any celebrity foundation. They spend most of their funding on PR campaigns, travel, and high end accomodations for themselves. Instead, go to Charitywatch.org and look up a top rated charity to support your favorite cause. In general support the little guy as much as possible and the big guy as little as possible. Do your part to reverse the transfer of wealth away from the rich and back to the middle and lower classes. Unfortunately, there is no perfect answer. Jobs will be lost either way. Innocent children will starve and die either way. But we need to support the largest group of workers with the most reasonable profit margins. We also need to support LEGITIMATE charities (Check that list at Charitywatch.org). This is our only chance to limit the severity and/or duration of the comming US/global depression. In the meantime, don't listen to Bernenke, Paulson, Bartiromo, Orman, Dobbs, Kramer, OReiley, or any other public figure with regard to the economy. They are all plenty smart but I swear to you that they will lie right through their rotten teeth. IT MAKES THEM RICHER. Like I said, you are welcome to run this by any professor of economics or socio-economics. If thats not good enough, then look up what Einstein had to say about greed, extreme wealth, and its horrible concequences. I speak the truth. GREED KILLS. IT WILL BE OUR DOWNFALL.

A word for those who choose to respond with the usual 'I know more than you. I'm smarter than you. Look how smart and

knowledgable I am.' crap. Let me say this in advance. I don't claim to be an expert in this field. But I'm no fool either. This is not brain surgery. For the mostpart, its simple math. Which is all I needed to predict the current recession in writing almost 3 years ago. Since then, I've gone on record against people like Greenspan, Bernenke, and Paulson. So far, my predictions have been accurate. Did any of my wise-ass 'know-it-all' critics see this comming way back in '05'? Hell no they didn't. So before you run with all of your stupid insults, you might want to consider my motives. I'm not here for attention or praise. I'm not here to compete with the rest of you. I'm here because I'm disgusted, angry, and scared silly. I really do see this as the greatest injustice of all time. I would cut my own arm off if I thought it would make a difference.

10:54 AM

Nick said...

Here's a comment I made on another blog in response to a query as to why oil prices fell by $10.50 in one day last week, slightly edited:

A small lowering of inflation expectations, for example from 5.5%/yr. to 5.3%/yr. or similar (it's the relative not absolute value that is important, and let's somewhat arbitrarily pick a 50-year timeframe), could and quite probably did cause the $10.50 decline in oil prices, just as increases in inflation expectations have earlier been increasing them. For some reason U.S. sovereign debt risk shifted significantly last week from inflation to overt default (see above story on the near-tripling in sovereign default risk for U.S. Treasuries), and this reason is probably related to the Fannie/Freddie bailout. My hypothesis for now is that the extreme pain caused by high oil prices has made overt default a more politically palatable prospect than hyperinflation, should it come to such a choice (and the Fannie/Freddie bailout made this extreme possibility more likely). Oil now has basically zero price stickiness and any inflationary Fed behavior is immediately reflected in higher oil prices, which would soon thereafter cause a political backlash. If you think $4.50/gallon for gas is bad, try $45/gallon or $450/gallon as soon as investors become convinced that crisis is probable and that the Fed is going the Zimbabwe/Weimar route instead of overt default. If overt default is more politically palatable than $45/gallon gas, from here on if the crisis deepens we will see overt default risk rise faster than commodity prices. (Of course, the chances of such a crisis either way are still much less than 50%, but quite significantly above zero).

1:27 PM

Anonymous said...

Good day !.
You may , perhaps curious to know how one can manage to receive high yields .
There is no need to invest much at first. You may start earning with as small sum of money as 20-100 dollars.

AimTrust is what you thought of all the time
AimTrust incorporates an offshore structure with advanced asset management technologies in production and delivery of pipes for oil and gas.

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Do you want to become an affluent person?
That`s your chance That`s what you wish in the long run!

I feel good, I began to get real money with the help of this company,
and I invite you to do the same. It`s all about how to choose a proper companion who uses your funds in a right way - that`s AimTrust!.
I earn US$2,000 per day, and my first deposit was 1 grand only!
It`s easy to join , just click this link http://mapivyxiq.ibnsites.com/pavepyl.html
and lucky you`re! Let`s take our chance together to become rich

6:27 AM

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